Supreme Court, U. S.
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IN THE

Supreme Court of the United States

No. 77-1325

M & M LEASING CORPORATION, *et al.*,
Petitioners,

v.

SEATTLE-FIRST NATIONAL BANK,
a national banking association, *et al.*,
Respondents.

and

M & M LEASING CORPORATION, *et al.*,
Petitioners,

v.

PEOPLES NATIONAL BANK OF WASHINGTON,
a national banking association, *et al.*,
Respondents.

ON PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

BRIEF OF RESPONDENTS

SEATTLE-FIRST NATIONAL BANK AND FIRSTBANK LEASING CORPORATION IN OPPOSITION TO THE PETITION FOR WRIT OF CERTIORARI

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I.

OPINIONS BELOW

The opinion of the United States District Court for the Western District of Washington (App. B to Petition) is

reported at 391 F. Supp. 1290. The opinion of the United States Court of Appeals for the Ninth Circuit (App. A to Petition) is reported at 563 F.2d 1377.

II.

JURISDICTION

The jurisdictional requisites are adequately set forth in the Petition.[1]

III.

QUESTION PRESENTED

Are the lease financing activities of the respondent banks within the "business of banking" and authorized by the National Bank Act?

IV.

COUNTERSTATEMENT OF THE CASE

A. Nature of the Case.

The petitioners sued Seattle-First National Bank (hereinafter "Seafirst") and Peoples National Bank of Washington, two national banks located in the state of Washington, seeking to enjoin their lease financing activities as being

1. The Petition does not, however, identify all of the parties to the action. Petitioners are: M&M Leasing Corporation; Goodway Leasing, Inc.; Bill Pierre Leasing, Inc.; and Budget Rent-A-Car of Washington-Oregon. Respondents are: Seattle-First National Bank and its wholly owned subsidiary, Firstbank Leasing Corporation; Peoples National Bank of Washington and its wholly owned subsidiary, Peoples Leasing Company; and James E. Smith, Comptroller of the Currency of the United States.

unauthorized under the National Bank Act.[2] The Comptroller of the Currency was joined as a defendant because of his ruling interpreting the National Bank Act as authorizing those lease financing activities. *See* 12 C.F.R. § 7.3400. Seafirst defended on the theory that its lease financing transactions were an authorized part of the business of banking because they are simply a new form of carrying out the historic bank function of credit extension. Specifically, the challenged lease financing transactions are authorized because from a banking perspective they are functionally interchangeable with "lending money on personal security," an expressly authorized bank activity. *See* 12 U.S.C. § 24(Seventh).

B. Seafirst's Leasing Program.

In 1968, Seafirst began lease financing in response to the desire of its customers to obtain the use of equipment through the lease format rather than by borrowing. At the present time, Seafirst is a lessor of a wide variety of goods, ranging from multi-million dollar commercial equipment to automobiles. Regardless of the equipment leased, the essential attributes of the Seafirst lease finance transaction are the same. The prospective lessee first selects the equipment he wishes to lease from a vendor of that type of equipment without any involvement of Seafirst. After making his selection, the prospective lessee requests that Seafirst purchase the equipment from the vendor and lease it to him. In determining whether to purchase and lease the

2. The petitioners have, on occasion, attempted to limit the scope of their challenge to the leasing of one product—automobiles. At other times, they have indicated that their challenge goes to the lease financing of all products by national banks. *See* 391 F. Supp. at 1297. In fact, as the district court recognized, there is no basis for distinguishing between the general activity of leasing and the activity of leasing a particular commodity. 391 F. Supp. at 1297.

equipment Seafirst investigates the creditworthiness of the potential lessee using the same criteria as it employs in evaluating applications for secured loans. Additionally, Seafirst evaluates the long-term value of the equipment proposed to be leased using the same criteria employed in evaluating collateral for secured lending. If the lessee qualifies on a credit basis and if the equipment qualifies on a collateral basis, Seafirst will purchase the equipment and lease it to the lessee pursuant to a "full payout finance lease."

A full payout finance lease is a lease in which the lessor is assured a return of its full investment in the leased property from sources other than the residual value of the leased equipment at the conclusion of the lease term. Thus, Seafirst need not sell the equipment at the conclusion of the lease for any particular amount to recover its costs incurred in the transaction. The second characteristic of the full payout finance lease is that the lease document shifts to the lessee essentially all of the operating costs and risks related to the leased equipment during the lease term. Accordingly, the lessee agrees to purchase insurance sufficient to cover Seafirst's interest, to pay for all repairs and maintenance, and to assume the risk of loss or damage to the leased equipment.

In its automobile lease financing transactions Seafirst uses the "open-end" lease format, one variation of the full payout finance lease. Pursuant to the open-end lease, the lessee agrees to pay over the term of the lease the amount which the vehicle is expected to depreciate during the lease term, plus an amount to compensate Seafirst for the extension of credit to the lessee. Additionally the lessee guarantees that the vehicle will have an agreed value at the time

of lease termination. The lease provides that at the end of the lease, the vehicle will be sold in the wholesale market. In the event that the sum realized from such disposition is less than the residual value agreed to at the time the lease was entered into, the lessee is obligated to make up that deficiency. If there is an excess of funds realized upon disposition, the excess is paid to the lessee. Assuming the lessee fulfills the credit obligation that is inherent in any credit transaction, Seafirst is assured a return of the cost to it of the leased vehicle plus a profit through lease payments and the guaranty of the residual value by the lessee. Seafirst's return on the transaction is in no way affected by the amount realized upon sale of the leased vehicle.

The lessee, rather than Seafirst, has the entire "stake" in the amount realized upon sale of a leased vehicle at lease termination. Because of this fact the vast majority of leased vehicles are not returned to Seafirst at the conclusion of the lease, but rather are purchased by the lessee or by an automobile dealer at the lessee's request. At the time of trial, in fact, Seafirst had never been involved in the sale of a leased vehicle which it did not repossess for failure of the lessee to pay the agreed rentals. Where Seafirst is called upon to dispose of an off-lease vehicle, it uses the same practices and procedures as are used by it in disposing of automobiles which serve as collateral for secured loans.

C. Full Payout Finance Leases Are an Extension of Credit.

At trial, the substance of the full payout finance lease, including the open-end lease, was the subject of extensive analysis. Economists, bank examiners, supervisors of ad-

ministrative agencies regulating banks, bankers, bank customers and experts in commercial and consumer credit unanimously testified that, from their perspectives, the full payout finance lease and the secured loan serve precisely the same function. Specifically, the opinion was unanimous that the full payout finance lease is, in essence, simply an extension of credit and is functionally equivalent to a secured loan.

D. The Opinions Below.

At conclusion of the trial, the district court found that the open-end lease "is merely a variation in the traditional manner of extending credit and is the functional equivalent of a loan on personal security." 391 F. Supp. at 1295. On the basis of this finding, the district court held that even a narrow reading of the National Bank Act authorized national banks to engage in such transactions because they are "directly related" to the express powers granted by the National Bank Act to "loan money on personal security" and to "discount evidences of debt." 391 F. Supp. at 1296. Upon the defendants' motion for clarification, the district court held that all full payout leases, regardless of whether they employ the open-end lease format, are authorized bank transactions. 391 F. Supp. at 1297. The district court, by way of limitation, concluded that if a national bank must rely on the residual value of the leased property to any extent to recover its investment in the leased goods, the transaction is not an authorized banking transaction. This limitation was not of substantial concern to Seafirst because it holds no leases in which the bank must look to the residual value to recover its investment.

The district court's conclusion that full payout lease financing transactions were authorized was appealed by pe-

titioners to the Ninth Circuit. The Comptroller cross-appealed the district court's *per se* prohibition of all bank lease financing transactions in which the recovery of any part of the bank's investment is dependent on the residual value of the leased equipment. The Ninth Circuit held that lease financing is an authorized national bank activity when, in light of all relevant circumstances, the transaction is functionally interchangeable with a secured loan. 563 F.2d at 1380, 1383. The Ninth Circuit concluded that such lease financing transactions are authorized under even a narrow reading of the powers granted national banks by the National Bank Act because they are incidental to the "loan of money on personal security," an activity expressly authorized by the Act. 563 F.2d at 1382. The Ninth Circuit affirmed the district court's conclusion that full payout lease financing transactions are within the scope of authorized bank powers. 563 F.2d at 1380. The Ninth Circuit went on to hold that a transaction may be functionally equivalent to a secured loan even where the lessor relies to a limited extent on the residual value of the leased equipment to recover its full investment. Thus, the Ninth Circuit reversed the district court's *per se* prohibition of all non-full payout leases. 563 F.2d at 1380, 1384.

V.

ARGUMENT

A. The Decision Below Is Clearly Correct.

The provision of the National Bank Act granting national banks "all such incidental powers as shall be necessary to carry on the business of banking" was first enacted in 1864 and has not been substantively amended since that date. 12 U.S.C. § 24 (Seventh). The statutory authorization does

limit banks to the "business of banking." It does not, however, restrict banks to those precise forms of carrying out that business which were employed in 1864 and expressly set forth in the statute. As the Ninth Circuit stated: "The powers of national banks must be construed so as to permit the use of new ways of conducting the very old business of banking." 563 F.2d at 1382.

The district court and the circuit court both noted that there are competing theories on the necessary relationship between the express powers set out in the National Bank Act and authorized bank activities. 563 F.2d at 1382; 391 F. Supp. at 1295-96. However, both courts correctly noted that even those cases requiring a close nexus between an express power and a challenged activity authorize those bank transactions which are "directly related," or, stated differently, "functionally interchangeable" with the express powers. 391 F. Supp. at 1296; 563 F.2d at 1382, 1383. *See, e.g., Colorado National Bank v. Bedford,* 310 U.S. 41, 49 (1940) (A national bank may operate a safe deposit box business because that activity is "similar" to an expressly authorized activity.); *Inland Waterways Corp. v. Young,* 309 U.S. 517, 523 (1940) (A national bank has the power to pledge its assets to secure deposits made by governmental agencies because that activity is functionally equivalent to an expressly authorized activity.).

The petitioners do not appear in their Petition to contest the Ninth Circuit's characterization of the necessary relationship between an express power set forth in the National Bank Act and an authorized incidental power. Their argument, rather, is that the district court and the circuit court misconstrued the record in finding that the transactions of the defendant banks are essentially financing,

rather than merchandising, in nature. (Petition, pp. 3, 8, 17, 19, 20, 22) That issue is, in large part, a factual one. The characterization of the challenged transactions as being essentially financing in nature and functionally equivalent to secured loans was compelled by the overwhelming trial testimony to that effect.

The characterization of the transactions adopted by the district court and the Ninth Circuit is in accord with the view of the Comptroller of the Currency. As this Court has previously noted, the Comptroller is the official in whom Congress has vested the power to define and to limit the means by which national banks can exercise their powers. *See Inland Waterways Corp. v. Young*, 309 U.S. 517, 524 (1940). The courts' holdings are also in accord with the findings of the Board of Governors of the Federal Reserve System. The Board of Governors is charged with the responsibility of delineating those activities which are "so closely related to banking or managing or controlling banks as to be a proper incident thereto." 12 U.S.C. § 1843(c)(8). Pursuant to its authority to delineate "closely related" activities, the Board in 1974 amended its Regulation Y to provide that lease financing of the type engaged in by Seafirst is the "functional equivalent of the extension of credit" and is, thus, "so closely related to banking . . . as to be a proper incident thereto." 12 C.F.R. § 225.4(a)(6).

In 1976, the Board of Governors reconsidered the specific question of whether open-end automobile leasing should continue to be construed as "closely related to banking." At the conclusion of a public hearing and after consideration of extensive comments raising the same "merchandising" argument raised by the petitioners here, the Board stated:

> On the basis of the record, the Board has concluded that automobile leasing, if conducted by a bank holding company in accordance with the Board's existing personal property regulation, is essentially a financial transaction that is functionally equivalent to a bank's lending function.

41 Fed. Reg. 45977, 45978 (October 19, 1976). The National Automobile Dealers Association appealed the Board's conclusion in *National Automobile Dealers Association, Inc. v. The Board of Governors of the Federal Reserve System,* (D.C. Cir. Cas. No. 76-2021). On February 21, 1978, the United States Court of Appeals for the District of Columbia Circuit, in an unpublished per curiam judgment, affirmed the Board's ruling.

The courts and administrative agencies having considered the issue are in accord that the challenged transactions are essentially financing in nature rather than a merchandising activity. There is no reasonable basis for concluding that this Court would, if it determined to consider the issue, arrive at a different result.

B. There Is No Conflict of Decisions.

No federal court decision conflicts, either directly or indirectly, with the decision of the Ninth Circuit in this case. The petitioners correctly observe that no federal court decision, other than those rendered in this case, addresses the issue of the authority of national banks to engage in lease financing. (Petition, p. 12) However, as noted above, in a case involving a related issue the District of Columbia Circuit has affirmed the conclusion of the Board of Governors of the Federal Reserve System that lease-financing of the type challenged here is "so closely related to banking as to be a proper incident thereto."

Further, the Ninth Circuit decision does not conflict with the long-standing line of judicial authority restricting banks to the "business of banking" and precluding them from engaging in "independent ventures." In those instances where courts have disallowed an activity on the grounds that it was an independent venture, the activity was not directly related to an expressly authorized bank activity and did not have as its primary purpose the provision of financing or any other essential bank function. *See Arnold Tours, Inc. v. Camp*, 472 F.2d 427 (1st Cir. 1972) (power to operate a travel agency); *National Retailers Corporation of Arizona v. Valley National Bank*, 411 F. Supp. 308 (D. Ariz. 1976) (power to offer a data processing service to the general public); *Merchants' National Bank of Cincinnati v. Wehrmann*, 202 U.S. 295 (1906) (power to improve and subdivide real estate). In this case, by contrast, the challenged activity is integrally related to the banks' performance of their express powers. As pointed out by the district court and the Ninth Circuit, even the narrow reading of the 12 U.S.C. § 24(Seventh) incidental powers clause adopted by the First Circuit in *Arnold Tours, Inc. v. Camp, supra*, authorizes the lease financing activities challenged here.

C. There Is No Important Question of Federal Law Involved.

The petitioners' argument that an important question of federal law is presented by this case centers on the assertion that many national banks are involved in lease financing and that the aggregate dollar size of those transactions is substantial. (Petition, pp. 14-15) The truth of that assertion does not make the legal issue in the case an important one. The challenged activity is merely one example of the fact that national banks have historically altered the

forms by which they extend credit to meet the needs of the public. A national bank's ability to do so is in accord with congressional intent and the narrowest past judicial interpretation of the National Bank Act. An important federal question, demanding Supreme Court attention, does not arise merely because a new form of performing the recognized credit extension function of national banks has become popular.

The petitioners urge, without persuasive explanation, that this case presents "the only time meaningful consideration of this issue can be had." (Petition, p. 13) Such is not the case. Should nonbank lessors be successful in other circuits in persuading the courts of a point of view which they have been unsuccessful in pressing before the Ninth Circuit, the Comptroller, the Federal Reserve Board, or the Court of Appeals for the District of Columbia Circuit, the issue could be presented to this Court in the context of a conflict of lower court decisions. There is no reason why, at that more opportune time, the possibility for review would have been foreclosed.

Lease financing by national banks and their affiliated corporations is a relatively recent phenomenon. The administrative agencies charged with the responsibility of regulating that activity are, as understanding grows, refining their definitions of the scope of permissible lease financing to assure that the authorized activity remains essentially financial in nature. For example the Federal Reserve Board, in October of 1976, revised its Regulation Y to more sharply define the scope of authorized lease financing by bank holding companies and nonbank subsidiaries of bank holding companies. 41 Fed. Reg. 45977, 45980 (October 19, 1976). Similarly, the Comptroller has proposed for com-

ment a revision to its personal property leasing ruling spelling out in comprehensive detail the scope of authorized national bank lease financing. *See* 42 Fed. Reg. 60749 (November 29, 1977). The Ninth Circuit correctly recognized that it is the function of the Comptroller, rather than of the courts, to promulgate a "comprehensive charter" restricting the lease financing activities of national banks to the business of banking. 563 F.2d at 1384. The Comptroller is able, and willing, to provide that guidance within the confines of the Ninth Circuit opinion. This Court should reject the invitation of the petitioners to define with greater particularity than did the Ninth Circuit the details of permissible lease financing by national banks. (Petition, pp. 23-25) That task is more appropriately the Comptroller's.

VI.

CONCLUSION

For the foregoing reasons, it is respectfully submitted that this petition for a writ of certiorari should be denied.

Respectfully submitted,

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